

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Central Illinois Light Company	:	
	:	02-0140
Request for the confidential treatment of	:	
the notice of transfer of generation assets	:	
to a subsidiary and entry into various	:	
agreements pursuant to Section 16-111(g)	:	
of the Illinois Public Utilities Act.	:	
Illinois Commerce Commission	:	
On Its Own Motion	:	
-vs-	:	02-0153
Central Illinois Light Company	:	
	:	
Proceeding pursuant to Section 16-111(g)	:	
of the Public Utilities Act concerning	:	
proposed transfer of generation assets to	:	Consolidated
a subsidiary and entry into related	:	
agreements.	:	

POST HEARING BRIEF

NOW COMES the Staff of the Illinois Commerce Commission (“Staff”), through its attorneys, and files its Post Hearing Brief in the above-captioned proceeding.

I. INTRODUCTION

A. Statement of the Case

On February 13, 2002, Central Illinois Light Company (“CILCO” or “Company”) filed, with the Illinois Commerce Commission (“Commission”), a Notice of Transfer of Generation Assets and Entry in Various Agreements (“Notice”) pursuant to Section 16-111(g) of the Illinois Public Utilities Act. (220 ILCS 5/1-101 *et seq.*) The filing gave notice of CILCO’s intent to sell its fossil-fueled generating facilities to Central Illinois Generation Company (“CIGI”). On the same date, the Company filed a Request for Confidential Treatment of the Notice of Transfer of Generation Assets.

In support of the Notice, CILCO filed the direct testimonies of Company witnesses: Robert Sprowls, Robert G. Ferlmann, and joint testimony of Brenda Freeman and Tom Bramschreiber. By order of the Commission on February 20, 2002, a proceeding to determine whether the proposed transfer of the electric generation stations should or should not be prohibited was initiated pursuant to Section 16-111(g)(vi). The two filings were also consolidated by that Commission order. Any action by the Commission must be taken by May 14, 2002.

A pre-hearing conference was held on March 4, 2002. A schedule was set for filing Staff/Intervenor testimony, Company rebuttal testimony, and hearings. In addition to Staff, the following parties intervened or participated in this matter: the City of Peoria ("Peoria") and the City of Pekin ("Pekin").

On March 13, 2002, Staff filed testimony in response to the Company's Notice and initial testimony. The Company did not file rebuttal testimony. CILCO filed a Draft Proposed Order on March 19, 2002. The hearing was held on March 21, 2002, at the Commission offices in Springfield, Illinois. Appearances were entered on behalf of CILCO, Peoria, Pekin, and Staff. Robert Sprowls, Robert Ferlmann, Brenda Freeman and Tom Bramschreiber provided testimony on behalf of CILCO. Thomas Q. Smith, Matthew Ulmer and Bruce A. Larson provided testimony for the Staff. At the conclusion of the hearings, the record was marked "Heard and Taken."

A schedule was adopted for parties to respond to the Company's Draft Proposed Order ("Draft").

II. PROPOSED CHANGES TO DRAFT

As indicated by the Draft, Staff, having reviewed the Notice in the contest of 16-111(g) and 16-128(d), does not oppose the proposed transfer. Staff made certain

recommendations which were accepted by CILCO. The proposed changes to the Draft are not substantive in nature.

A. Section I

The witnesses, for whom there was no cross-examination, did not testify at the hearing. Thus, the following changes are suggested for the 5th paragraph on page 2:

At the hearing, ~~Robert Sprowls, President of CILCO and Vice President of CILCORP,~~ Brenda Freeman, Finance Team Member on the Finance and Administration Team of CILCO, Tom Bramschreiber, Project Director with AES Great Plains Inc., testified on behalf of CILCO. The testimony of Robert Sprowls, President of CILCO and Vice President of CILCORP, was entered into evidence. (CILCO Ex. 1.0 at 7) Thomas Q. Smith, an Accountant in the Accounting Department of the Financial Analysis Division; Bruce Larson, a Senior Analyst in the Electric Section in the Engineering Department of the Energy Division; and Matthew L. Ulmer, a Financial Analyst in the Finance Department of the Financial Analysis Division provided testimony ~~testified~~ on behalf of Staff of the Illinois Commerce Commission.

B. Section V.

1. Paragraph A.

In support of the statement in the Notice, Robert Sprowls, the President of CILCO, testified that the Company irrevocably committed that CILCO would not, as a result of the Transfer impose stranded cost charges. The following change is suggested:

4. Commitment Regarding Stranded Cost Charges

Section 16-111(g) subsection (iv) requires an irrevocable commitment by the electric utility that it will not, as a result of the transaction, impose any stranded cost charges that it might otherwise be allowed to charge retail customers under federal law or increase the transition charges that it is otherwise entitled to collect under Article XVI of the Public Utilities Act-PUA. In its Notice and in CILCO President, Robert Sprowls', testimony, CILCO irrevocably committed that it will not, as a result of the Transfer, either impose any stranded cost charges that it might otherwise be allowed to charge retail customers under federal law or

increase the transition charges that it is otherwise entitled to collect under Article XVI. (CILCO Ex. 1.0 at 7)

2. Paragraph B

The citations to Section 16-128(c) of the Act should be changed to reference Section 16-128(d) of the Act.

B. Section 16-128(ed)--Effect on Current Employees

Section 16-128 of the Act provides that “if a utility transfers ownership during the mandatory transition period of one or more Illinois. . . generating stations or generating units of an electric utility to a majority-owned subsidiary, that subsidiary shall continue to employ the utility’s employees who were employed by the utility at such . . . generating station at the time of the transfer under the same terms and conditions of employment as those employees enjoyed at the time of the transfer.” 220 ILCS 5/16-128(ed)

Because CIGI is a wholly-owned subsidiary of CILCO, Section 16-128(d) is applicable. CILCO states that CIGI has committed to continue to employ all of CILCO’s generating-station employees under the same terms and conditions of employment for as long as required by Section 16-128(d).

C. Section VI

1. Subsection A.

Exhibits submitted by CILCO and entered into evidence contained different exhibit numbers than those referred to in the Draft.

A. Provision of Tariffed Services in Safe and Reliable Manner

CILCO states that it will enter into a Power Supply Agreement (“PSA”) under which CIGI will supply CILCO with the power and energy necessary to serve the needs of CILCO’s retail customers and meet its MAIN reliability requirements. CILCO states that until the PSA expires on December 31, 2004, CIGI has the obligation to provide or manage the full requirements of CILCO. ~~(Appendix M~~ CILCO Ex. 3.0 at 2)

CILCO states that to meet its obligation, CIGI will, for the most part, use the same power supply assets that were used by CILCO to provide

service to its customers. CILCO states that CIGI will operate the generation assets being transferred, will be the exclusive agent to schedule various peaking facilities and to obtain power through contracts and, will be assigned certain power and firm energy contracts CILCO has executed to meet summer peaking load obligations. (~~Appendix M~~ CILCO Ex. 3.0 at 2-3)

CILCO states that pursuant to the PSA and under normal operating circumstances, CILCO pays fixed demand and energy charges for bundled load based upon the System Capacity Requirement, which is determined on an annual basis. CILCO states that under the PSA, it may request, at the stated base contract rate, an increase in the System Capacity Requirement of up to 4% for any contract year. CILCO asserts that using its demand forecasting models, 4% is adequate to cover the load growth even assuming that no customers switch to alternative suppliers. CILCO says that under the PSA, CILCO may request additional capacity in excess of the System Capacity Requirement. CILCO also says it may request a reduction in the System Capacity Requirement of up to 10% for any contract year. (~~Appendix M~~ CILCO Ex. 3.0 M at 3-4)

CILCO asserts that under normal operating conditions, the effect of setting the demand and energy charges for bundled service load requirements in this way is to insulate CILCO from risk that those charges could increase. CILCO states that, for example, even if maintenance or fuel costs were to increase for any one of numerous reasons, the same fixed demand and energy rates would apply. CILCO claims that under the PSA, CIGI will bear these price risks that are currently borne by CILCO. (~~Appendix M~~ CILCO Ex. 3.0 at 3)

Staff witness Larson testified that the PSA would not substantially change how CILCO will be able to provide safe and reliable service to CILCO's customers. Mr. Larson indicated that the following terms of the PSA are significant to CILCO's ability to provide safe and reliable service after transfer of the fossil units:

- CILCO's plants will be dispatched according to provisions of the PSA. The PSA's provisions are the same as CILCO's dispatch practices before the transfer of the generating plants.
- Maintenance outages will be coordinated according to provisions of the PSA. The PSA's provisions are the same as CILCO's maintenance outage coordinating practices before the transfer of the generating plants.
- The parties will continue to conform to all applicable NERC and regional reliability council principles, guides, criteria and standards and industry standard practices and conventions for reliable system operation.
- The transfer does not change any of the personnel working at the

plants.

(Staff Ex. 3 at 2-3)

Mr. Larson testified that CILCO's reliability would not suffer if an Independent System Operator ("ISO") or Transmission Company is not in place by the time the PSA expires or is cancelled. He asserts that this would only mean that CILCO, not the ISO or Transmission Company, would be responsible, as CILCO is now, for assuring safe operation of the transmission system in CILCO's control area. (Staff Ex. 3 at 3)

It is Staff's position that while CILCO has sufficient capacity to continue the provision of adequate and reliable service, CILCO's resources will be deficient in 2004. Staff indicates that CILCO would be deficient the same amount if the transfer did not take place. Currently, CILCO has two and a half years to arrange for more capacity. Staff believes that is sufficient time to purchase or build more capacity. (Staff Ex. 3 at 3-4)

Staff states that after expiration of the PSA, contractual and regulatory constraints will continue to require that CILCO operate its system in a safe and reliable manner. Staff indicates that CILCO's plans to reliably serve load after the mandatory transition period assumes that competitive wholesale and retail markets will exist. (Id.)

2. Subsection B.

Again, CILCO's exhibit numbers were changed subsequent to the filing of the Draft. Changes are also suggested regarding the characterization of Mr. Ulmer's testimony.

B. Likelihood that CILCO Could Request an Increase in Base Rates During The Mandatory Transition Period

As noted above, Section 16-111(g) (vi) also allows the Commission to prohibit the proposed Transfer if it finds that there is a strong likelihood the proposed Transfer will result in CILCO being entitled to request an increase in its base rates during the mandatory transition period pursuant to Section 16-111(d) of the Act.

CILCO's projected returns on equity, with and without the proposed Transfer, were set forth on Appendix N to the Notice. CILCO compared its projected two-year average earned returns on equity to the yields of 30-year U.S. Treasury Bonds. CILCO projected its returns on equity assuming no retail load loss to alternative generation providers. (Appendix

N CILCO Ex. 2.0 at 5)

CILCO states that it believes the level of customer switching that may occur is not a function of whether or not the generating assets are transferred to CIGI. CILCO also states that any financial impact arising from customer switching, positive or negative, would occur regardless of the transfer of generation assets. In other words, the difference between bundled service rates and delivery service rates plus any wholesale revenue from freed-up energy sales does not depend on whether CILCO or CIGI owns the generating assets. CILCO claims the net income and common equity of CILCO, as reported in FERC Form I will not be affected by the proposed transfer of generation assets. (~~Appendix N~~ CILCO Ex. 2.0 at 5)

CILCO states that it has not experienced any retail load loss to alternative generation providers, to date. CILCO indicates that for purposes of this proceeding, it developed financial projections assuming an increasing level of annual retail load loss to alternative generation providers: 5% in 2002, 10% in 2003, and 15% in 2004. (~~Appendix N~~ at 9) CILCO also performed a set of analyses, which it characterized as a “hyper switching” scenario, where it assumed retail load loss to alternative generation providers was 10% in 2002, 20% in 2003 and 30% in 2004. (~~Appendix N~~ CILCO Ex. 2.0 at 12)

CILCO states that the average monthly yield of 30-year U.S. Treasury bonds for the twenty-four month period ending December 31, 2000 was 5.72%. CILCO also states that the current spot yield for 30-year U.S. Treasury bonds is 5.40% and the standard deviation of two-year average monthly returns over the last decade was 0.73%. CILCO says the standard deviation is a statistical measure of how widely values are dispersed from the average value. (~~Appendix N~~ CILCO Ex. 2.0 at 6)

According to CILCO, adding two standard deviations to the current spot bond yield produces a probability of approximately 95% that 30-year U.S. Treasury bond yields will be no higher than 6.26%. For comparison purposes, CILCO assumed 6.86% to be the projected average annual monthly yield of 30-year U.S. Treasury Bonds. (~~Appendix N~~ CILCO Ex. 2.0 at 6-7)

CILCO claims its unadjusted two-year average returns on common equity have ranged from 8.37% to 14.14% over the last decade. CILCO asserts that there is a positive correlation between its earned return on common equity and 30-year U.S. Treasury Bond yields. CILCO states that its unadjusted two-year average return on common equity has exceeded the two-year average 30-year U.S. Treasury bond yield by a minimum of 250 basis points in every corresponding period, with an average difference of over 450 basis points. (~~Appendix N~~ CILCO Ex. 2.0 at 7)

It is CILCO's position that the projected earned returns on common equity through the mandatory transition period indicate that the transfer of generation assets will not affect its returns such that there is a strong likelihood that CILCO would be entitled to seek an increase in its base rates. CILCO claims under assumptions of either no customer switching or assuming switching at rates of 5% in 2002, 10% in 2003, and 15% in 2004, the projected earned returns on common equity are well above the projected average annual monthly yields of 30-year U.S. Treasury bonds. (~~Appendix N~~ CILCO Ex. 2.0 at 11 and 12-13) CILCO states that even under the "hyper switching" scenario, CILCO's projected return on common equity is at least two standard deviations above current 30-year U.S. Treasury Bond yields.

~~Staff witness Ulmer indicated that the Company's projected returns on common equity ("ROE") assume a gradual decrease in retail sales. Mr. Ulmer testified that the Company's projected ROE indicate that there is a possibility that CILCO will be entitled to request an increase in base rates during the mandatory transition period pursuant to Section 16-111(d) but that possibility is not impacted whatsoever by the proposed transaction. (Staff Ex. 2 at 2-3)~~

It is Staff's position that the asset transfer has no impact on CILCO's ROE since it would retain ownership of those assets through a subsidiary. Staff contends that expenses the wires company incurs as a result of purchasing power from CIGI are reported as revenue on CIGI's financial statements. According to Staff, these transactions exactly offset one another and as such do not affect consolidated net income and common equity, which are used to determine eligibility for base rate increases under section 16-111(d) of the Act. Staff concludes that the transaction would not increase the likelihood that the Company would be eligible to request an increase in base rates under section 16-111(d) of the Act. Staff asserts that, in contrast, CILCO's projected ROE might ~~would~~ have been affected if CILCO had elected to transfer the assets to an affiliate it did not own. (Staff Ex. 2 at 7-8)

C. Findings and Ordering Paragraphs

Staff proposes that the findings and ordering paragraphs adopt Mr. Smith's request that a copy of the executed Services and Facilities Agreement be filed with the Commission and provided to the Manager of the Commission Accounting Department. A new finding should be included:

(12) CILCO shall file with the Commission a copy of the executed Services and Facilities Agreement, and, at the time of filing, shall provide a copy of this

filing to the Manager of the Commission's Accounting Department.

The ordering paragraph referencing finding (11) should be amended to include a reference to new, finding (12).

IT IS FURTHER ORDERED that CILCO shall comply with Findings (11) and (12) of this Order.

III. CONCLUSION

For the foregoing reasons, the Staff of the Illinois Commerce Commission respectfully requests that the Commission order reflect Staff's recommendations.

Respectfully submitted,

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